1996 ANNUAL REPORT

NEWQUEST
ENERGY INC.

Contents

Corporate Profile

Newquest Energy Inc. (Newquest) was incorporated on September 6, 1994 and began active operations October 1, 1995 after closing its initial public offering. The Company has an aggressive exploration philosophy and focuses its efforts on three Core Areas in the Province of Alberta. All growth to date has been a result of drilling activity rather than production acquisitions, underscoring our evolution as a true exploration company. The Company's goal is to continue to provide value and growth for its shareholders by focusing on high quality and high deliverability, internally-generated exploration opportunities in its Core Areas.

Newquest's Class A and Class B shares trade on The Alberta Stock Exchange under the trading symbols "NQE.A" and "NQE.B".

Annual Meeting

The Annual General Meeting will be held at 10:00 o'clock a.m. on Wednesday, June 11, 1997 in the main boardroom at the offices of Code Hunter Wittmann, Barristers and Solicitors, Suite 1400, 700-2nd Street S.W., Calgary, Alberta.

Cover Legend

As a true exploration company, Newquest utilizes two-dimensional and three-dimensional seismic data to determine the best prospects for drilling. The cover depicts both the advanced technology and drilling components that have resulted in the Company's growth.

Abbreviations

apo	after payout
ARTC	Alberta Royalty Tax Credit
bbls	barrels
bbl/d	barrels per day
boe	barrels of oil equivalent (10 mcf equals 1 bbl of oil)
boe/d	barrels of oil equivalent per day
bopd	barrels of oil per day
bpo	before payout
mbbls	thousand barrels
mmboe	million barrels of oil equivalent
mmcf/d	million cubic feet per day
mcf/d	thousand cubic feet per day
mstb	thousand standard tank barrels
NGL	natural gas liquids

1996 Results

- drilled 36 gross wells
- averaged 160 boepd
- year-end production of 200 boepd
- proven and probable reserves increased to 2.34 mmboe

1997 Goals

- drill over 50 high working interest wells
- maintain on-stream costs of less than $5.00/boe

CORPORATE HIGHLIGHTS

	Year Ended December 31, 1996	Period Ended December 31, 1995
Financial ($ except share data)		
Petroleum and Natural Gas Sales	**1,573,354**	40,330
Funds from Operations	**931,166**	–
Per Share (basic)	**0.26**	–
Per Share (fully diluted)	**0.18**	–
Net Income	**257,811**	–
Per Share (basic)	**0.07**	–
Per Share (fully diluted)	**0.05**	–
Capital Expenditures	**8,614,711**	667,064
Working Capital	**5,053,149**	5,884,870
Weighted Average Class A		
Shares Outstanding		
Basic	**3,632,157**	2,012,250
Fully Diluted	**5,117,883**	2,322,925
Operations		
Production		
Natural Gas		
Daily (mcf/d)	**26**	0
Total (mcf)	**9,377**	0
Oil & NGLs		
Daily (bbl/d)	**160**	6
Total (bbl)	**58,339**	2,190
Prices		
Natural Gas ($/mcf)	**1.07**	0
Oil & NGLs ($/bbl)	**26.79**	20.30
Reserves Proven & Probable		
Natural Gas (mmcf)	**17,328**	543
Oil & NGLs (mbbls)	**612**	280
Present Value of Reserves		
($000's disc. at 10% before taxes)	**17,733**	2,642
Undeveloped Acreage Holdings		
Gross Acres	**41,574**	4,320
Net Acres	**20,669**	538
Option Lands		
Gross Acres	**90,800**	0
Wells Drilled		
Gross	**36.00**	5.00
Net	**15.90**	1.01

Certain prior year comparative figures are not available as the Company was in its pre-production stage until January 1, 1996.

Newquest
Fast Facts

- a true exploration company
- three core areas of focus
- pursuing several major land deals

- operatorship
- high working interests
- focus on drilling, seismic & facilities

Summary

The successful results of an aggressive 36 well drilling program during the year ended December 31, 1996 highlighted Newquest's first full year as an operating, publicly-listed company. Newquest emerged as a pure exploration enterprise, achieving growth solely through the drilling and development of new oil and natural gas reserves concentrated in three Core Areas in the Western Canada Sedimentary Basin. The Company posted strong financial results for the year, increased daily oil, liquids and natural gas production and added to its petroleum reserves base. Newquest increased its inventory of drilling prospects through purchases at Crown land sales and participation agreements.

On behalf of the Board, I am pleased to report that during the period, Newquest achieved a cash flow of 26 cents per basic share (18 cents per fully diluted share) and net income of 7 cents per basic share (5 cents per fully diluted share) from revenues of $1.6 million, derived principally from petroleum and natural gas sales, net of royalties, of $1.35 million.

The Company averaged 160 barrels of oil equivalent per day production (boepd) during the year. At the end of 1996, Newquest had 200 boepd of production; at the end of the first quarter of 1997 this grew to 315 boepd and currently stands in excess of 600 boepd.

The Foundation

During late 1995 Newquest closed its initial public offering in anticipation of a strong 1995/96 winter drilling program. The Company deliberately and methodically established drilling and land opportunities as it identified core areas for focus. Newquest's first well as a public company, a 55 percent working interest prospect at Grand Forks, Alberta, was an oil discovery which it drilled as the operator. Shortly after, Newquest negotiated its first multi-well joint venture commitment within the North Central Core Area. As the Company evolved and progressed, it continued to refine and develop its strategies. These events provided a foundation for growth and set in motion the activities for the 1996 fiscal year.

1996 Milestones

In its 1995 annual report to shareholders, Newquest committed to growth through the drill bit, supported by a land position developed through Crown acquisitions and by selective farm-in opportunities within focus areas.

During 1996 Newquest adhered to these policies and made substantial progress through the following steps:

- Defined three Core Areas in Alberta on which to focus activity: North Central, Central and South Eastern. The Company will continue to concentrate on establishing drilling targets, production and reserves in each Core Area.
- Developed a high quality prospect inventory supported by large contiguous land bases accumulated within each Core Area.
- Strengthened its core of personnel with talented technical and operational Company-builders capable of meeting ambitious goals. Their trust and dedication contribute continuously to the evolution of the Company and to adding significant value for shareholders.
- Spent $8.6 million on capital programs during 1996 and found its entire production and reserves base through the drill bit.
- Participated in drilling 36 wells, maintaining high working interests equivalent to 15.9 net wells drilled.
- Discovered several oil and natural gas pools within its North Central and South Eastern Core Areas.
- Acted as operator in virtually all drilling and development activities by year end.
- Increased reserves to 2.34 million equivalent barrels of proven and probable oil and natural gas reserves, as evaluated by the Martin Petroleum & Associates independent report effective January 1, 1997.
- Increased the undeveloped land base to more than 40,000 gross acres.
- Secured an important option on an additional 90,000 gross acres of land within the North Central Core Area.
- Secured $7.35 million of additional equity capital during the last quarter of 1996 to further the aggressive exploration programs.

1997 Exploration Program

The Company's land base, which was expanded considerably during 1996, will sustain an active drilling program in 1997 and beyond. Newquest enters the year with over 50 high working interest drilling opportunities that could accommodate a capital budget of $25 million. To ensure the availability of equipment, Newquest secured the services of two drilling rigs on a long term basis. Newquest will strive to operate and maintain a high working interest in the entire drilling program. The Company's drilling targets will be balanced equally between oil and natural gas, under 2,000 meters in depth, of moderate cost and near existing infrastructure. This drilling program will fulfill Newquest's goal to increase production in 1997 with on-stream costs of less than $5.00 per boe.

Newquest continues to pursue opportunities within its three areas of focus. Several major land deals are being pursued to complement its current activities. In addition, the Company is developing a land base within Central Alberta for the 1998 season.

1997 Outlook

In 1997 the Company faces the challenge of increasing production in the face of limited rig availability, rising land prices and increasingly expensive property acquisitions. The Company expects commodity prices to remain favourable. In March, 1997 West Texas Intermediate crude oil futures traded above US $21.10 per bbl and it is very difficult to predict a sustained drop in price to below US $18.00 per bbl. Worldwide demand for crude oil appears to be increasing and Iraq's partial return to the market has had a minimal impact on the price.

With respect to natural gas, a cold winter, lower storage levels and indications of a weaker deliverability surplus have resulted in favorable prices. Newquest realizes that commodity price volatility can prove either positive or negative for the Company, and therefore minimizes exposure by employing a wellhead price of C$1.50 per thousand cubic feet in all of its evaluations and analysis.

Rig availability has become a concern as fleet utilization rates approach full capacity. To combat this Newquest signed long term contracts with two drilling contractors to ensure that its drilling program will be carried out in a timely and cost-effective manner. This gives Newquest a competitive edge as an exploration company committed to production growth through drilling for new reserves.

Rising demand for exploratory acreage resulted in the Alberta land prices averaging $170 per hectare during 1996. During the first quarter of 1997, land prices averaged above $235 per hectare. To support its ambitious growth plans, Newquest will continue to farm-in on land opportunities in Core Areas in order to secure large contiguous land blocks. The Company will continue to direct its capital spending on seismic acquisitions to further its competitive advantage, high impact drilling opportunities and production facilities.

Acknowledgments

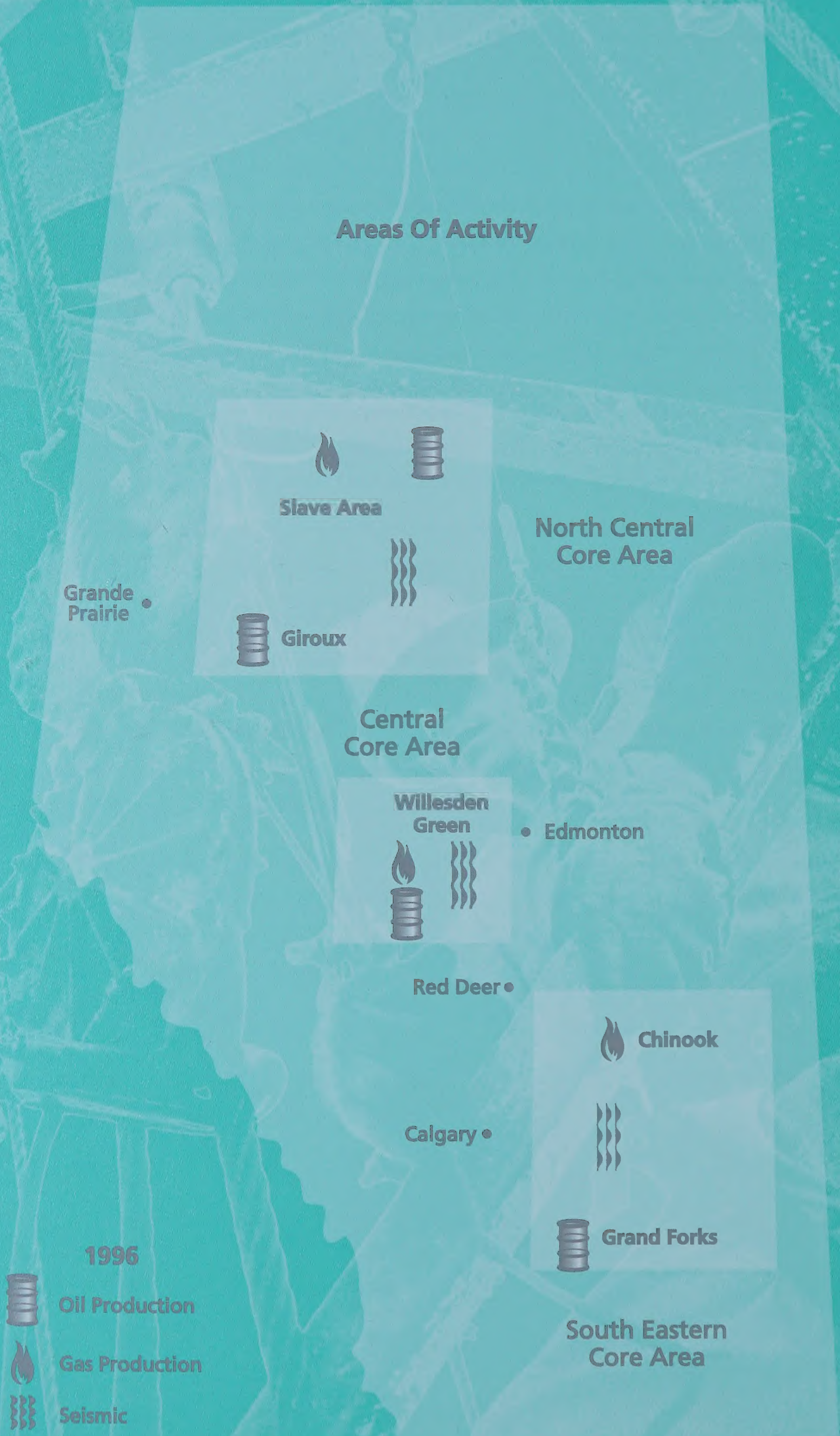
The credit for Newquest's success belongs to the efforts of its team of employees and directors. I take this opportunity to thank all our people for their efforts in the past year and I am confident they will continue their exemplary performance in 1997. I wish to extend a warm welcome to Tom Code who has joined us in the capacity of Chief Operating Officer and Director and John Nadurak as Operations Manager.

We value the support of our shareholders and have every reason to believe 1997 will be an excellent growth year.

On behalf of our management and the Board,

TMShklanka

Taras M. Shklanka,
President and Chief Executive Officer
April 21, 1997


Areas Of Activity
Slave Area
North Central
Core Area
Grande
Prairie
Giroux
Central
Core Area
Willesden
Green
Edmonton
Red Deer
Chinook
Calgary
Grand Forks
South Eastern
Core Area
1996
Oil Production
Gas Production
Seismic

Overview

Newquest Energy's first full year of operations has been very exciting with the drilling of 36 wells in which the Company retained a net working interest equivalent to 15.9 wells. To date, Newquest has amassed a considerable land base amounting to 57,975 acres. In addition, the Company has acquired options on 116,000 gross acres of highly prospective exploratory lands in Alberta. The land base provides the Company with more than 50 drillable prospects for 1997.

During 1996 Newquest continued to define and implement fundamental strategies in its core areas of Alberta. These are the North Central, Central and South Eastern Core Areas.

1997 Growth

In 1997, Newquest will pursue the drilling and development in each of the three Core Areas with a consistent strategy:

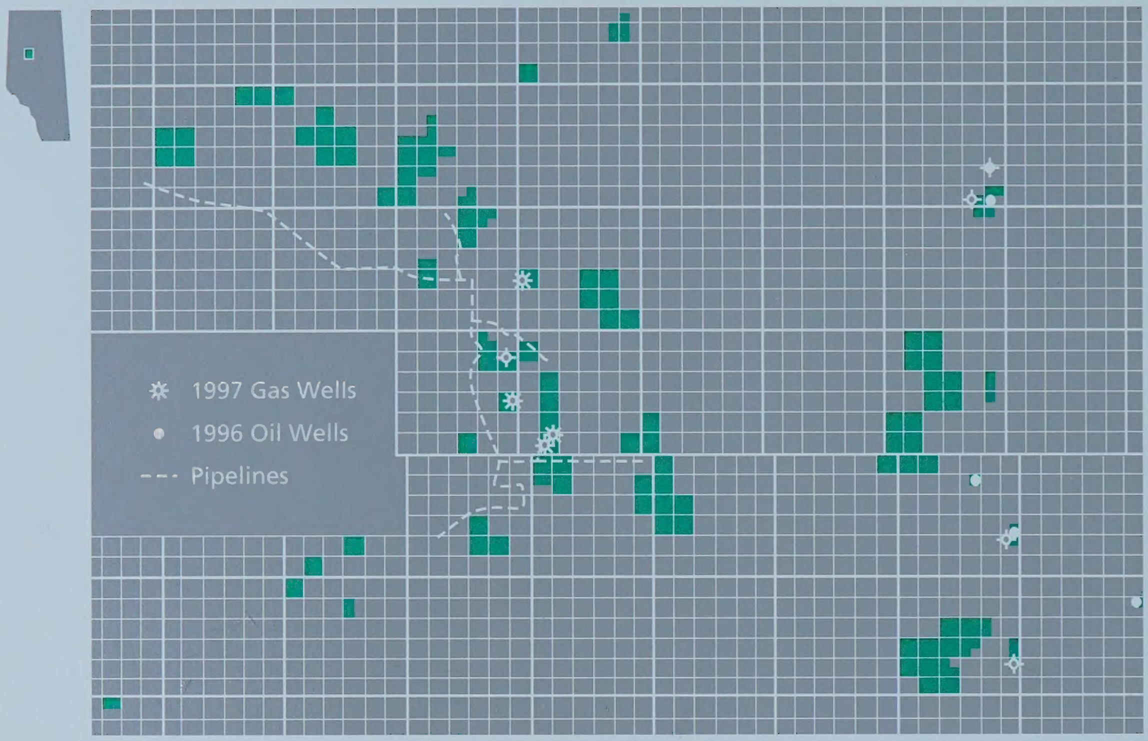
1. To target high quality and high impact reservoirs by:
   - concentrating on areas that are well understood by management and staff;
   - utilizing seismic data wherever possible;
   - focusing on prospects proximal to infrastructure, to ensure early cash flow; and
   - undergoing a detailed analysis on all projects for economic and risked potential.
2. To obtain/maintain a significant land base in each Core Area.
3. To maintain a large prospect inventory, allowing the Company to high grade its prospects and invest in its best exploration opportunities.
4. To maintain operatorship, to assure control and management of projects.
5. To maintain a high working interest, so that each project maximizes shareholder value.

NORTH CENTRAL CORE AREA

In 1996 Newquest participated in the drilling of 20 wells (7.28 net wells) in the North Central Core Area. Of these, 11 wells (2.4 net) were cased as oil wells, one well (1.0 net) was cased as a natural gas well and eight wells (3.88 net) were abandoned. Current net production from these wells is 111 boepd. The Company expects this production to increase significantly once a waterflood scheme is instituted at its Giroux Lake discovery. Through other farm-ins and acquisitions, Newquest added over 20,000 acres of land in the North Central area in 1996.

During the second quarter of 1996, Newquest consummated a large area wide farm-in with Gulf Canada Resources Limited in the Slave Lake area of northwestern Alberta, involving over 90,000 acres of high working interest lands. The farm-in lands are highly prospective for both oil and natural gas reserves.

Slave Area



Slave Properties

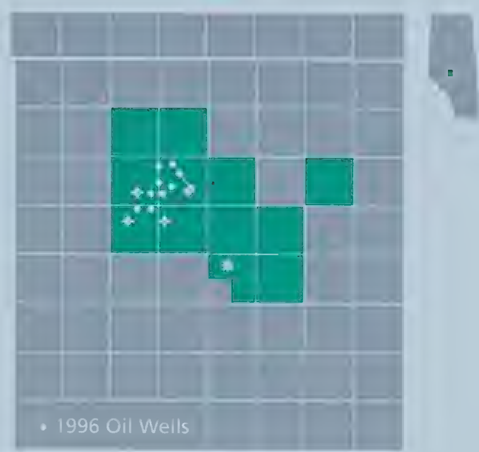
In the first quarter of 1996, Newquest participated in a joint venture which involved drilling nine oil locations in the Loon and Utikuma areas of the Slave region. Newquest's interest in these wells averaged approximately 50 percent. Four of the wells were successful and three wells are currently producing.

On January 31, 1997 Newquest elected on all of the earning blocks associated with the Gulf Canada Resources Limited farm-in. To the end of the first quarter of 1997, the Company drilled three 100 percent Newquest wells, all cased as natural gas wells. Due to surface conditions associated with break-up, only one of the wells has been tied-in. As of April 15th, this well was producing 3.1 mmcf/d net to Newquest. The plans for 1997 involve drilling an additional six natural gas and five oil locations on the farm-in lands. Based on access conditions, some of these prospects may be drilled this summer.

The plans for 1997 in this area include the drilling of 20 potential wells equally split between oil and natural gas. Newquest anticipates at least two years of active exploration and development activities on this very large land base. There are also a number of other strategic initiatives that the Company is pursuing to further enhance the Company's economic benefit in this area. Due to the very prospective nature of this part of the Western Canada Sedimentary Basin, Newquest foresees that this area will greatly enhance the Company's overall growth.

Giroux Lake Interests

In 1996 Newquest was involved in the drilling of 10 wells (2.9 net) in the Giroux Lake area, with Company interests varying between a Gross Overriding Royalty and 100 percent working interest. Newquest believes the potential exists for a 1.5 million-barrel field, based on the 1996 drilling results. Work with the operator is currently being performed to institute a waterflood in the pool to accommodate increased production rates, which should be implemented by May 1, 1997. Newquest also has 100 percent lands in the vicinity, where the potential exists for a similar-size Notikewin oil pool. During the first quarter of 1997 a 100 percent Newquest exploratory well was cased as a potential oil well, to be completed when access conditions permit.

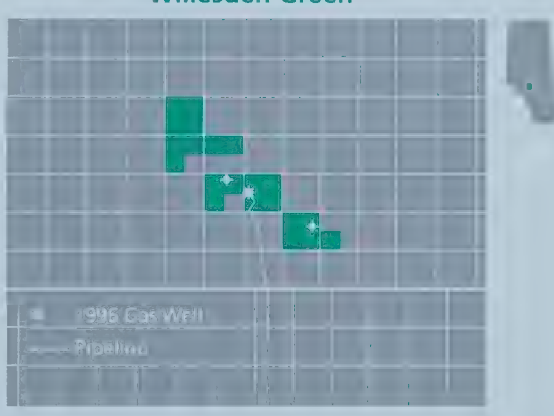


CENTRAL CORE AREA

The Central Core Area saw limited activity in 1996. The area, though prospective and intriguing to the Company, is very competitive due to the multiple-zone hydrocarbon potential. Newquest is currently developing plans and strategies which should see this area as a major focus of our efforts in the latter part of 1997 and in 1998.

Willesden Green Properties

During 1996 Newquest participated in the drilling of 3 wells (1.5 net). Two of the wells were dry and therefore abandoned, while the third well was completed as a successful natural gas well which was placed on stream in March, 1997. The well is currently producing 69 boepd net to the Company. Newquest holds 2,880 acres of land in this area. Future plans for the area depend on the acquisition of additional prospective land holdings.



SOUTH EASTERN CORE AREA

The South Eastern Core Area was a major area of exploration for Newquest in 1996. This Core Area is attractive because of the multiple-zone potential of drilling locations and the availability of under-utilized infrastructure. Unique innovations in the use of seismic exploration will be employed in this area.

The Company has participated in the drilling of 11 wells (6.0 net), seven of which were cased. Two are producing oil and three are producing natural gas. During the year the Company was able to acquire 19,500 acres of land in the area.

Chinook Properties

In the Chinook/Sedalia area, Newquest has acquired 13,760 acres through farm-ins and Crown land sales. The Company operated the drilling of four wells (2.4 net) in 1996; three of the wells have been cased as natural gas wells and two are currently producing from three stratigraphic horizons with net production to Newquest of 750 mcf/d.

Based on the land the Company has accumulated to date, the potential for future farm-ins and acquisitions, plus extensive use of seismic exploration, Newquest anticipates the drilling of 15 wells in this area in 1997.

Chinook Area

Grand Forks Properties

Early in its evolution, Newquest acquired an interest in acreage with potential for Sawtooth oil production. With the extensive use of 3-D seismic, the Company developed three oil locations (1.8 net). In the latter part of 1995 and early 1996, these wells were drilled by Newquest as operator and cased as oil wells. Two of the wells are currently producing. No future development or exploratory activities are presently planned for this area.

Drilling Summary

In 1996, Newquest participated in the drilling of 36 wells, including 13 wells drilled by the Company as operator. In the future the Company intends to operate most of the wells in its drilling program.

	1996		1995	
	Gross	Net	Gross	Net
Oil	14	3.84	2	.68
Natural Gas	6	3.90	2	.20
D & A	16	8.18	1	.13
	36	15.92	5	1.01
Average W.I.	44.2%		20.2%	
Success Rate	56%		80%	

Land Holdings

Newquest's undeveloped land base increased to over 41,500 acres in 1996 and the Company had another 90,800 gross acres under option. The Company's philosophy is to acquire, through large, area wide farm-ins and Crown sales, large expanses of land in areas in which it will be active. Newquest believes that large acreage holdings enable the Company to fully exploit the technical capabilities of its management and staff.

	1996		1995	
	Gross	Net	Gross	Net
Developed Acres	8,081	4,710	1,480	196
Undeveloped Acres	41,574	20,669	2,840	342
Total Acres	49,655	25,379	4,320	538
Option Acres	90,800	–	–	–

Reserves Summary

The volumes and present value of Newquest's production reserves have been independently evaluated as at January 1, 1997 by Martin Petroleum & Associates in their report dated March 24, 1997 (the "Martin Report"). The following tables summarize the Martin Report. The present value of the estimated future revenue before tax to be derived by the Company's petroleum reserves includes the Alberta Royalty Tax Credit.

Reserves Volumes

As at January 1, 1997

	Company's Share of Remaining Reserves (Before Royalties)		
	Crude Oil mstb	Natural Gas mmcf	mboe
Proved Developed			
Producing	363	2,359	599
Non-Producing	39	4,172	456
Total Proved	402	6,531	1,055
Probable Additional	210	10,797	1,290
Total	612	17,328	2,345
Total Proved plus 1/2 Probable	507	11,929	1,700

Present Value of Estimated Future Net Revenue Before Tax ($ Thousands)

As at January 1, 1997

		Discounted at		
	Undiscounted	10%	15%	20%
Proved Developed				
Producing	9,686	6,351	5,429	4,754
Non-Producing	4,854	3,073	2,555	2,166
Total Proved	14,540	9,424	7,984	6,920
Probable Additional	13,696	8,309	6,777	5,632
Total	28,236	17,733	14,761	12,552
Total Proved plus 1/2 Probable	21,388	13,578	11,372	9,736

Martin Petroleum & Associates Price Forecast

As at January 1, 1997

Year	WTI at Cushing $US/bbl	Alberta Oil Par Price $/bbl	Alberta Gas Par Price $/mcf	Inflation %	Rate $US/$Cdn
1997	21.00	26.50	1.60	0	0.74
1998	21.00	26.50	1.80	3	0.74
1999	21.00	26.50	2.00	3	0.74
2000	21.50	27.10	2.20	3	0.74
2001	22.25	28.10	2.35	3	0.74
2002	23.00	29.10	2.50	3	0.74
2003	23.75	30.10	2.60	3	0.74

Finding and On-stream Costs ($ Thousands except reserve additions)

	Dec. 31, 1996	Dec. 31, 1995
Finding Costs		
Land	**1,151**	11
Seismic	**671**	58
Drilling and Completion	**5,894**	488
Finding Costs	**7,716**	557
Equipping Wells	**720**	69
Production Facilities	**176**	5
On-Stream Costs	**8,612**	631
Reserve Additions (mboe)		
Oil and NGLs	**390**	280
Gas	**1,679**	54
Total Proved plus Probable Reserve Additions	**2,069**	334
Cost Per boe		
Finding ($/boe)	**3.72**	1.67
On-stream ($/boe)	**4.16**	1.89

1996 Results

achieved oil and gas sales of $1.6 million

per share funds from operations were $0.18 fully diluted

net income per share was $0.05 fully diluted

declining production expenses

increasing netbacks

Revenue

Petroleum and natural gas revenues increased steadily throughout the year as the Company advanced its drilling program and properties were brought on-stream. First quarter revenues totalled $171,920 and were comprised entirely of medium and light quality crude oil from the North Central and South Eastern Core Areas. Production revenues during the second quarter were again comprised entirely of crude oil and increased to $347,485 as the result of development drilling in the South Eastern Core Area. Exploration drilling during the third quarter resulted in a new light oil pool discovery in the North Central Core Area, which helped to increase production revenues to $475,151. The Company's first natural gas well was also brought on-stream during the third quarter; however, this only accounted for one percent of revenues during the period. Fourth quarter production revenues increased to $578,798 as a result of development drilling in the North Central Core Area, with medium and light quality crude oil accounting for 99 percent of revenues.

During 1996, the Company's average selling price for oil was $26.79 per bbl while the modest natural gas sales averaged $1.07 per mcf. As a result of market expectations for crude oil prices, the Company entered into a contract to hedge 2,750 barrels of production per month beginning October 1, 1996. The contract guaranteed a price of $29.10 per bbl for a six month period.

Royalties

Royalties, net of the Alberta Royalty Tax Credit, averaged $3.81 per boe or 14.3 percent of gross revenue. Royalty expenses consisted of $1.06 per boe of net Crown royalties and $2.75 per boe of freehold royalties. The reduction of Crown royalties as a result of the ARTC averaged $2.91 per boe.

Production Expenses

Production expenses totalled $230,447 for the year and averaged $3.89 per boe. During the first quarter, production expenses averaged $4.50 per boe, and reduced consistently throughout the year to $3.16 per boe by the fourth quarter. The Company is making an effort to reduce these costs by concentrating on opportunities which it can operate in order to more effectively control costs and maximize production. It is management's intention to operate the majority of its exploration and development projects to control the timing and extent of production and associated costs.

Netbacks ($/boe)

	Q1	Q2	Q3	Q4	1996
Price	22.99	24.39	27.05	28.96	**26.55**
Royalties (net of ARTC)	3.31	2.79	4.05	4.51	**3.81**
Production Expenses	4.50	4.37	4.06	3.16	**3.89**
Netbacks	15.18	17.23	18.94	21.29	**18.85**

General and Administrative

General and Administrative (G&A) costs were $860,270, less recoveries of $52,748 and capitalized G&A of $461,194 for a net of $346,328 or $5.84 per boe produced. As 1996 marked the first full year of operations and all growth was obtained through exploration efforts, we anticipate that the per barrel G&A costs will decline as the Company grows. At the end of 1996, the Company had six full-time employees, plus three full-time/part-time consultants. Six of these personnel were dedicated to exploration efforts and it is the efforts and talents of these people that have resulted in the Company's production success.

Interest Expense

Newquest has established a $2 million revolving bank line of credit to support operations. The Company did not draw down the line of credit during 1996, and as such no interest costs were incurred.

Depletion, Depreciation and Site Restoration

Newquest's depletion and depreciation was $333,834 for 1996 or $5.63 per boe produced. Provision for future site restoration was $23,521 or $0.40 per boe.

Newquest annually applies a ceiling test to comply with the Company's policy for accounting for oil and natural gas properties under the full cost method. This ensures that oil and natural gas property and equipment do not exceed the estimated value of future net revenues from the Company's existing reserves at year-end prices, less future general and administrative expenditures related to those reserves and income taxes. As a result of the test performed at December 31, 1996 no write-down in asset book value was required.

Deferred Income Taxes

Newquest issued $6,010,400 of flow-through shares as part of its initial public offering in September, 1995. The Company committed to renouncing the associated tax deductions by December 31, 1996. This was achieved by renouncing $2,521,500 effective to December 31, 1995. The remaining $3,488,900 was renounced effective to December 31, 1996. Additional flow-through offerings were completed in 1996 and all associated renunciations for these offerings were made effective to December 31, 1996.

Funds from Operations

Funds from operations increased substantially from quarter to quarter as the Company's drilling program advanced during its first full year of operations. Funds from operations during 1996 were as follows:

	Q1	Q2	Q3	Q4	1996
Funds from Operations ($)	141,691	185,861	250,258	353,356	**931,166**
Funds from Operations per share ($)					
Basic	.04	.05	.07	.10	**.26**
Fully Diluted	.03	.04	.05	.06	**.18**

Net Income

Although poor weather conditions hampered the Company's efforts to bring production on-stream during the second and third quarter, net income also demonstrated strong growth during the year as follows:

	Q1	Q2	Q3	Q4	1996
Net Income ($)	72,901	69,122	32,466	83,322	**257,811**
Net Income per share ($)					
Basic	.02	.02	.01	.02	**.07**
Fully Diluted	.01	.01	.01	.02	**.05**

Liquidity and Capital Resources

Newquest, and the subsequently amalgamated company 627402 Alberta Ltd., were incorporated in the fall of 1994 with an initial shareholder capitalization of $300,000. The Company went public in September, 1995 after closing its initial public offering of $6,830,000. Newquest continued to increase its capitalization in 1996, raising $7,350,000 through the issue of Class A shares. The Company has funded all activity to date through equity and cash flow and has not utilized bank debt. Newquest has established a $2,000,000 revolving bank line of credit for operational purposes based on its drilling program to the end of the first quarter of 1996. As at year-end 1996, the Company maintained a $5,053,149 working capital position.

Sensitivity Analysis

The following table outlines the effect of commodity price fluctuations based on expected 1997 production, and the effect of production volume fluctuations.

	Cash Flow	Cash Flow per Basic Share
	$	$
Gas price ($0.20/mcf)	93,500	0.02
Oil price (Cdn. $1.00/bbl)	74,250	0.01
Gas volume (1.00 mmcf/d)	294,000	0.05
Oil volume (100 bbl/d)	570,000	0.10

Net Asset Value

	As at Dec. 31, 1996
	$
Proved plus 1/2 Probable Reserves discounted at 10% before tax	13,578,500
Undeveloped acreage	1,152,000
Seismic and other assets	729,047
Working Capital	5,053,149
Net asset value	20,512,696
Net asset value per Class A share outstanding December 31, 1996	3.62
Proceeds from the exercise of stock options and warrants	636,149
*Net asset value per Class A share fully diluted	2.92

*Assumes the conversion of 601,040 Class B shares into 1,167,068 Class A shares based on a closing price of $5.15 on December 31, 1996. Also assumes the exercise of 360,000 stock options and 58,656 warrants December 31, 1996 into Class A shares for considerations of $577,493 and $58,656, respectively.

MANAGEMENT'S REPORT

The financial statements of Newquest Energy Inc. were prepared by management in accordance with accounting principles generally accepted in Canada. The financial and operating information presented in this annual report is consistent with that shown in the financial statements.

Management has designed and maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of reliable and timely financial statements for reporting purposes. Timely disclosure requires the use of estimates when transactions affecting the current accounting period cannot be finalized or known for certain until future periods. Such estimates are based on judgments made by management using all relevant information known at the time.

External auditors appointed by the shareholders have examined the corporate and accounting records in order to express their opinion on the financial statements. The Audit Committee, consisting of a majority of non-management directors, has met with the external auditors and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The Audit Committee has reported its findings to the Board of Directors who have approved the financial statements.

Neil A. Runions,
Vice President, Finance

To the Directors of Newquest Energy Inc:

We have audited the balance sheets of Newquest Energy Inc. as at December 31, 1996 and 1995 and the statements of operations and retained earnings for the year ended December 31, 1996 and of changes in financial position for the year ended December 31, 1996 and the periods from May 15, 1995 to December 31, 1995 and from incorporation, September 6, 1994 to May 15, 1995. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1996 and 1995 and the results of its operations for the year ended December 31, 1996 and the changes in its financial position for the year ended December 31, 1996 and the periods May 15, 1995 to December 31, 1995 and from incorporation, September 6, 1994 to May 15, 1995 in accordance with generally accepted accounting principles.

Deloitte & Touche

Chartered Accountants

Calgary, Alberta
March 14, 1997

BALANCE SHEETS

	December 31,1996	December 31, 1995
Assets	$	$
Current		
Cash and short-term investments	6,443,083	5,868,821
Accounts receivable	862,880	257,144
Prepaid expenses	26,315	18,864
	7,332,278	6,144,829
Capital Assets (Note 3)	6,664,913	483,334
	13,997,191	6,628,163
Liabilities		
Current		
Accounts payable and accrued liabilities	2,279,129	259,959
Provision for Site Restoration Costs	23,521	–
	2,302,650	259,959
Shareholders' Equity		
Share capital (Note 4)	11,436,730	6,368,204
Retained earnings	257,811	–
	11,694,541	6,368,204
	13,997,191	6,628,163

Approved by the Board

Director

Director

STATEMENT OF OPERATIONS AND RETAINED EARNINGS

	Year ended December 31,1996
Revenue	$
Petroleum and natural gas sales	1,573,354
Royalties, net of Alberta Royalty Tax Credit	(225,671)
	1,347,683
Interest	160,258
	1,507,941
Expenses	
Operating	230,447
General and administrative	346,328
Depletion and depreciation	357,355
	934,130
Earnings Before Income Taxes	573,811
Deferred Income Taxes (Note 6)	316,000
Net Income	257,811
Retained Earnings, Beginning of Year	
Retained Earnings, End of Year	257,811
Net income per share (Note 7)	0.07

	For the year ended December 31, 1996	For the period from May 15, 1995 to December 31, 1995	For the period from incorporation, September 6, 1994 to May 15, 1995
Net Inflow (Outflow) of Cash Related To The Following Activities	$	$	$
Operating			
Net income	257,811	–	–
Items not involving cash			
Depletion and depreciation	357,355	–	–
Deferred income taxes	316,000	–	–
Funds from operations	931,166	–	–
Changes in non-cash operating working capital	1,405,983	(16,049)	–
	2,337,149	(16,049)	–
Financing			
Issue of shares	7,438,418	6,830,000	300,000
Share issue costs	(586,594)	(578,066)	–
	6,851,824	6,251,934	300,000
Investing			
Capital assets (Note 3)	(8,614,711)	(520,977)	(146,087)
Cash Increase	574,262	5,714,908	153,913
Cash and Short Term Investments Beginning of Period	5,868,821	153,913	–
Cash and Short Term Investments End of Period	6,443,083	5,868,821	153,913
Funds from Operations per Share (Note 7)	0.26	–	–

For the Year ended December 31, 1996, and for the Periods May 15, 1995 to December 31, 1995 and from incorporation, September 6, 1994 to May 15, 1995

1. Incorporation and Amalgamation

Newquest Energy Inc. (the "Corporation") was incorporated under the laws of the Province of Alberta on September 6, 1994. 627402 Alberta Ltd. ("627402") was incorporated on October 5, 1994. 627402 was owned initially by the initial shareholders of the Corporation and became a wholly-owned subsidiary of the Corporation on May 15, 1995 when the Corporation issued 975,000 of its Class A shares to acquire all of the shares of 627402. On May 15, 1995, the Corporation filed Articles of Amalgamation to amalgamate with its wholly-owned subsidiary, 627402. The business combination has been accounted for as a pooling of interests. Under this method of accounting for a business combination, the assets, liabilities, capital and revenues and expenditures of the two companies are combined at their original recorded amounts as if the two companies had been combined since incorporation.

2. Significant Accounting Policies

Basis of presentation

The Corporation's activities during the period from date of incorporation to December 31, 1995 are related to exploration for and development of petroleum and natural gas properties. Such activities are considered to be in the pre-production stage. All costs associated with such activities, net of revenues, have been included as deferred exploration costs as a component of capital assets (Note 3). Accordingly, there is no statement of operations included with the financial statements for the period from date of incorporation to December 31, 1995. All deferred costs have been transferred to the Corporation's full cost pool as of January 1, 1996.

Petroleum and natural gas operations

Effective from January 1, 1996, the Corporation follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized into a single Canadian cost centre. Such costs include land acquisition costs, costs of drilling, both productive and non-productive wells, geological and geophysical expenditures, well equipment and certain other overhead expenditures related to exploration.

Capitalized costs, including tangible well equipment, are depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by management and reviewed by an independent reserve engineer. The relative volumes of petroleum and natural gas reserves and production are converted to a common unit of measure on the basis of 6 mcf of gas to 1 barrel of oil.

2. Significant Accounting Policies (continued)

Gains or losses on the sale or disposition of petroleum and natural gas properties are not ordinarily recognized except under circumstances which result in a major revision of depletion rates. Depreciation of other equipment is computed using the straight line method over five years.

The Corporation applies a "ceiling test" annually to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Corporation's year end, and the costs of unproven properties less impairment. Future net revenues is calculated after deducting general administrative costs, financing costs and income taxes.

Joint ventures
Substantially all of the Corporation's exploration and development activities are conducted jointly with others, and accordingly the financial statements reflect only the Corporation's proportionate interest in such activities.

Flow-through shares
The Corporation has issued flow-through shares and special warrants. Under these financing arrangements, shares are issued at a fixed price and the resultant proceeds are used to fund exploration and development work within a defined time period. The exploration and development expenditures funded by flow-through arrangements are renounced to investors in accordance with the appropriate tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated benefits of the renounced tax deductions when expenditures are incurred.

Future site restoration and abandonment costs
The Corporation provides for future site restoration and abandonment costs, based on the unit-of-production method. The provision is included in depletion and depreciation in the statement of operations.

3. Capital Assets

	December 31, 1996		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	$	$	$
Petroleum and natural gas properties	6,960,520	326,476	6,634,044
Office furniture and equipment	38,227	7,358	30,869
	6,998,747	333,834	6,664,913

3. Capital Assets (continued)

	December 31, 1995
Deferred exploration costs	$
Petroleum and natural gas properties	130,722
Well equipment	74,514
Production and administrative costs	362,833
Oil and gas reserves, net of royalties	(31,429)
Interest income	(88,661)
	447,979
Office furniture and equipment	35,355
	483,334

Petroleum and natural gas properties are presented net of $2,283,028 (1995 - $183,730) of income taxes relating to income tax deductions which have been renounced to the Corporation's shareholders under flow-through share arrangements (Note 4). Included in petroleum and natural gas properties at December 31, 1996 are $1,152,000 of costs related to undeveloped land which is not being depleted.

4. Share Capital

Authorized

Unlimited number of Class A shares

Unlimited number of Class B shares

Issued:	Number of Shares	Amounts
Class A, Voting		$
Balance, beginning of period	–	–
Initial private issue for cash	525,000	105,000
For shares of 627402	975,000	195,000
Balance May 15, 1995	1,500,000	300,000
Issued for cash	2,049,000[ii]	819,600
Share issue costs	–	(69,368)
Balance December 31, 1995	3,549,000	1,050,232
Issued for cash		
Options and warrants exercised	108,417[i]	88,418
Class A flow-through shares	500,000[i]	1,950,000
Class A shares	1,000,000[i]	3,500,000
Class A shares issued in exchange for flow-through special warrants	500,000	1,900,000
Share issue cost		(586,594)
Tax benefit from share issue costs	–	89,000
Balance December 31, 1996	5,657,417	7,991,056

4. Share Capital (continued)

Class B, Non-Voting		
Balance, beginning of period	–	–
Issued for cash	601,040(ii)	6,010,400
Share issue costs	–	(508,698)
Tax benefit renounced relating to flow-through shares	–	(183,730)
Balance December 31, 1995	601,040	5,317,972
Tax benefit from share issue costs	–	227,000
Tax benefit renounced relating to flow-through shares	–	(2,099,298)
Balance December 31, 1996	601,040	3,445,674
Total at December 31, 1996		11,436,730

Notes:

(i) The Corporation issued 500,000 flow-through Special Warrants at $3.80 per Special Warrant for gross proceeds of $1,900,000 on October 29, 1996. Each Special Warrant was converted into one Class A Share for no additional consideration prior to December 31, 1996.

The Corporation filed a final prospectus dated December 6, 1996 to qualify for distribution the 500,000 flow-through Class A Shares to be issued on exercise of Special Warrants. The final prospectus also qualified the distribution of 500,000 flow-through Class A Shares at a price of $3.90 per share for gross proceeds of $1,950,000 and 1,000,000 Class A Shares priced at $3.50 per share for gross proceeds of $3,500,000.

(ii) Under a prospectus dated August 18, 1995, the Corporation issued to the public a total of 6,830 units, each unit consisting of 300 Class A shares and 88 "flow-through" Class B shares.

(iii) Class B shares may be converted (at the option of the Corporation) at any time after June 30, 1999, and before June 29, 2001, into Class A shares. The fraction is calculated by dividing $10 by the greater of $1 and the then current market price of the Class A shares. If conversion has not occurred by the close of business on June 29, 2001, the Class B shares become convertible (at the option of the shareholder) into Class A shares. Effective on August 31, 2001, all remaining Class B shares will be deemed to be converted to Class A shares.

4. Share Capital (continued)

Share options and warrants

During the year, the Corporation granted options to acquire 99,998 (1995 - 340,000) Class A shares at $3.825 per share (1995 - $0.75), exercisable over a five year period and expiring at various times to December 12, 2001.

At December 31, 1996, the Corporation has remaining 260,002 options to acquire Class A shares at $0.75 per share and 99,998 options to acquire Class A shares at $3.825 per share. The Corporation also has outstanding at December 31, 1996, 58,656 (1995 - 67,823) warrants for purchase of Class A shares at $1.00 each.

Flow-through shares

Certain Class A shares and the Class B shares were issued as qualifying flow-through shares for income tax purposes. The tax benefit of $2,283,028 in aggregate to December 31, 1996 has been recorded as a reduction of share capital and of petroleum and natural gas properties.

5. Line of Credit

The Corporation has a bank line of credit available to a maximum amount of $2,000,000.

6. Income Taxes

(a) Income tax expense is different from the amount computed by applying the combined expected Canadian federal and provincial tax rates of 44.6% to income before taxes. The reasons for these differences are as follows:

	For the Year Ended December 31, 1996
	$
Computed expected tax expense	256,000
Increase (decrease) in taxes resulting from:	
Crown royalties	105,000
Alberta royalty tax credit	(77,000)
Depletion of non-tax base assets	79,000
Resource allowance	(54,000)
Other	7,000
	316,000

(b) Petroleum and natural gas properties with a cost of approximately $2.8 million at December 31, 1996 have no cost base for income tax purposes.

7. Earnings per Class A Share

The basic net earnings per Class A share of $0.07 for 1996 and the basic funds from operations per Class A share of $0.26 have been calculated using 3,632,157 Class A shares, representing the weighted average number of shares outstanding during the year ended December 31, 1996. The fully diluted earnings per Class A share of $0.05 and fully diluted funds from operations per Class A share of $0.18 have been calculated using 5,117,883 shares, representing the fully diluted weighted average number of shares outstanding during the year after taking into account all share options and assuming the conversion of Class B Shares to Class A Shares occurred at the end of the year, using the December 31, 1996 price of $5.15.

The conversion of Class B shares into Class A shares is dependent upon the trading price of the Class A shares. Fully diluted earnings and funds from operations per Class A share could vary significantly in the future depending upon the future trading price of the Class A shares.

8. Related Party Transactions

The Corporation has entered into a Participation Agreement and a Reciprocal Participation Agreement with Baytex Energy Ltd. ("Baytex"), a shareholder company. Pursuant to the Participation Agreement, which terminates no later than February 28, 1997, Baytex is obliged to offer the Corporation up to 50% of Baytex's interest in a sufficient number of drilling prospects in a designated region pursued by Baytex which would enable the Corporation to spend up to 30% of the gross proceeds of its initial public offering. Under the Reciprocal Participation Agreement, which terminates no later than February 28, 1997, the Corporation is obliged to offer Baytex up to 50% of its interest in a sufficient number of drilling prospects in a designated region pursued by the Corporation, up to an amount equal to 30% of the gross proceeds of the initial public offering. Newquest has since fulfilled its obligation to Baytex under the Reciprocal Participation Agreement.

9. Commitments

The Corporation has entered into a contract to hedge a portion of its oil production. The price is $29.10 per barrel on 2,750 barrels of production per month for a six month period commencing October 1, 1996.

The Corporation has an obligation to make the following future minimum lease payments on various operating leases.

1997	$ 52,376
1998	$ 52,764

CORPORATE INFORMATION

Board of Directors

Taras M. Shklanka
President, Chairman of the Board

Neil A. Runions
Chief Financial Officer

J. Thomas Code
Chief Operating Officer

Norbert P. Kloster
Chief Financial Officer
Baytex Energy Ltd.

Raymond A.F. Wilkinson
Corporate Director

Officers & Key Personnel

Taras M. Shklanka
President, Chief Executive Officer

Neil A. Runions
Vice President, Finance

J. Thomas Code
Chief Operating Officer

Gregory G. Turnbull, Secretary
Partner, Code Hunter Wittmann

John J. Nadurak
Manager of Operations

Stanley S.Y. Lui
Geophysical Manager

Bruce K. Shepard
Exploration Manager

D'Arcy R. Lincoln
Senior Geologist

Barry W. Roebuck
Controller

Julie S. Dykstra
Office Manager

Auditors

Deloitte & Touche
Suite 2400, Scotia Centre
700 - 2nd Street S.W.
Calgary, Alberta
T2P 0S7

Solicitors

Code Hunter Wittmann
Suite 1400, Scotia Centre
700 - 2nd Street S.W.
Calgary, Alberta
T2P 4V5

Bankers

Alberta Treasury Branches
239 - 8th Avenue S.W.
Calgary, Alberta
T2P 1B9

Evaluation Engineers

Martin Petroleum & Associates
Suite 500, 808 - 4th Avenue S.W.
Calgary, Alberta
T2P 3E8

Registrar and Transfer Agent

Montreal Trust Company of Canada
Suite 600, 530 - 8th Avenue S.W.
Calgary, Alberta
T2P 3S8

Exchange Listing

The Alberta Stock Exchange
Stock Symbols: NQE.A
NQE.B

Executive Offices

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